

2004-10-26

BANKS ACT CIRCULAR 16/2004

TO ALL CHIEF EXECUTIVE OFFICERS OF BANKS, BRANCHES OF FOREIGN BANKS AND MUTUAL BANKS

AUDITOR ROTATION

At a meeting of the Standing Committee for the Revision of the Banks Act, 1990, held on 7 June 2002, it was decided that this Office should investigate effecting an amendment to section 61 of the Banks Act, 1990 (Act No. 94 of 1990 – “the Banks Act”), to incorporate the rotation of auditors of banks. Recent international corporate failures, such as those of Enron and WorldCom, called for the adoption of an approach of rotation of auditors of banks and controlling companies of banks, in order to enhance the independence of auditors and, thereby, maintain an objective approach to the auditing and disclosure of banks’ financial affairs. Several of the more prominent banking and insurance regulators worldwide have in recent years adopted such an approach.

The above-mentioned amendment to section 61 of the Act was effected during August 2003 by the Banks Amendment Act, 2003 (Act No. 19 of 2003). Section 61(1)(b) of the Banks Act states that “any person contemplated in paragraph (a) shall be appointed for such period and on such conditions as may be prescribed”. In line with the said requirement, this Office circulated a letter to the auditing profession and several other affected parties, explaining the process that this Office envisaged for the rotation of the auditors of banks and controlling companies of banks. Comments received from banks and auditing firms were duly considered, and final implementation details are set out hereunder.

1. Application of rotation

Rotation of an auditing firm will not be required, but rather rotation of an auditing firm’s partners. The rotation of auditing partners will apply only to the lead partners and engagement partners conducting the audit of a bank or controlling company of a bank when such a controlling company is registered in the Republic of South Africa.

The terms lead partner and engagement partner may broadly be defined as follows:

Lead partner – The lead partner is the partner who has overall and final responsibility for the audit of a bank or the controlling company of a bank. The lead partner would also have responsibility for signing the annual financial statements and presenting the findings of an audit to the audit committee of a bank.

Engagement partner - The engagement partner has responsibility for managing and coordinating the auditing work that is being undertaken in respect of a bank or its controlling company. The engagement partner may also have responsibility for auditing one or more of the segments, divisions or subsidiaries of such a bank or controlling company. The engagement partner would normally liaise with the lead partner on important matters relating to the former's area of responsibility.

In certain auditing firms, use is made of a concurring partner to provide another level of objectivity on the auditing work undertaken by the lead and engagement audit partners. Although requests were received to include concurring partners in the rotation process, this Office was of the opinion that the inclusion of concurring partners in the rotation process was unnecessary. The roles and functions of the concurring partners in the audits of banks and controlling companies of banks should be managed by the auditing firms, in order to ensure that the roles and functions of concurring partners do not encroach on the roles and functions of the lead or engagement partners.

After rotation, both lead partners and engagement partners may not be involved in the audit of a bank or its controlling company for a specified period. Therefore, after rotation, an engagement partner may not become the lead partner of the same bank or controlling company for a specified period, as set out in point 2 below.

2. Time periods applicable

It is envisaged that the maximum period that a partner may be involved as a lead partner or engagement partner will be five years. Thereafter, the lead and engagement partners will not be permitted to become the lead or engagement partner of the same bank or its controlling company for a period of three years, the so-called "time-out" period. Although requests were received to shorten the time-out period to two years, this Office was of the opinion that in order to align the time-out period with current corporate-governance structures, the time-out period should remain three years.

3. Commencement of rotation

The rotation of partners will apply retrospectively, starting with the rotation of lead partners after completion of 2004 financial year-end audits until and including 31 December 2004. Lead partners who would have audited a particular bank or its controlling company in that capacity for a period of five years or longer as at completion of the 2004 financial year-end audit shall rotate on completion of the

year-end audit until and including 31 December 2004. Lead partners who have audited a particular bank or its controlling company in that capacity for a period of less than five years as at 31 December 2004 shall complete the remaining portion and shall rotate on completion of the five-year period.

In order to ensure continuity, the rotation of engagement partners will commence after completion of the 2005 financial year-end audits until and including 31 December 2005. Engagement partners who would have audited a particular bank or its controlling company in that capacity for a period of five years or longer as at completion of the 2005 financial year-end audit shall rotate on completion of the 2005 financial year-end audit until and including 31 December 2005. Engagement partners who would have audited a particular bank or its controlling company in that capacity for a period of less than five years as at 31 December 2005 shall complete the remaining portion and shall rotate on completion of the five-year period.

Although requests were received to allow the five-year period to be interrupted, this Office is of the opinion that, in the interest of stability, interruption of the five-year period should not be allowed. Therefore, should the engagement period of a lead partner or engagement partner for any reason be less than the envisaged period of five years, the "time-out" rule will apply before such a partner may be reinstated as lead or engagement partner.

4. Joint auditors

In cases of two auditing firms having been appointed by a bank or controlling company of a bank, rotation of the first lead partner will start after completion of the 2004 financial year-end audit until and including 31 December 2004. The second lead partner may rotate one year thereafter, after completion of the 2005 financial year-end audit until and including 31 December 2005. Rotation of the first engagement partner will take place after completion of the 2005 financial year-end audit until and including 31 December 2005, and the second engagement partner will rotate after completion of the 2006 financial year-end audit until and including 31 December 2006. Although rotation of the lead and engagement partners will be required by law, such rotational plans should be discussed with the management of the particular bank or controlling company and should be implemented in an orderly fashion, under prior advice to the Registrar of Banks.

5. Specialist partners

This Office will not require the rotation of so-called specialist partners, that is, partners dealing with issues of a specialised nature, such as taxation issues.

6. Acknowledgement of receipt

Two additional copies of this circular are enclosed for the use of your institution's independent auditors. The attached acknowledgement of receipt, duly completed and signed by both the chief executive officer of the institution and the said auditors, should be returned to this Office, at the earliest convenience of the aforementioned signatories.

E M Kruger
Registrar of Banks

The previous circular issued was Banks Act Circular 15/2004 dated 21 September 2004.